

## **Labor Economics II** **Spring 1999**

### **Instructor:**

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### **Office Hours:**

Wednesday 11-1, or by appointment.

### **Course Objectives:**

The objective of the course is to acquaint students with modern topics, modelling strategies, econometric methods, and empirical work in the field of labor economics. In this first semester of the two-semester sequence in labor economics, we will cover topics in the analysis of labor market dynamics [(unemployed) search and informational models of turnover], equilibrium models of comparative advantage and sorting, issues of labor market selection [signalling models], models of the employment relationship when moral hazard is present, the effect of minimum wages on labor market outcomes, and human capital investment decisions in equilibrium frameworks. For each of the eight topics covered in the course we will begin by presenting some of the relevant theoretical models which have been developed. We will then turn our attention to issues of model specification and estimation given the type of data typically available to labor economists [except when we discuss signalling models]. Approximately two-thirds of the course will be devoted to labor market theory and one-third to the specification and estimation of econometric models of the labor market. Empirical results will be discussed when appropriate.

### **Prerequisites:**

One year of microeconomic theory and concurrent registration in or completion of Econometrics II.

### **Requirements and Grading:**

There will be two examinations in the course, a midterm and a final. The midterm exam will be given in class on Monday, March 8 and the final will be given during the final examination period. Both examinations

will ask the student to apply what they have learned in class to the modeling of labor market phenomena, as well as to synthesize and/or critique the theoretical and econometric models which are presented in the lectures and/or the required readings. The examinations will have equal weight in the determination of the student's final grade.

In addition students will be asked to give approximately two reports on a few of the assigned readings in class [the readings will be selected by the student after consulting with me]. The reports will consist of a summarization of the basic argument of the paper(s), the model, and econometric methodology and results [where appropriate]. The purpose of this exercise is to increase class participation and to familiarize students with the presentation of economic research; hopefully this experience will prove useful when students begin their own research careers.

**Readings:**

The items on the reading list in *italic* are required readings. Copies of these will be on reserve in the C.V. Starr Center library on the third floor of 269 Mercer. Students who have difficulty finding other readings in which they are interested [especially unpublished working papers] should contact me.

## Lecture Schedule

<i>Week</i>	<i>R.L. #</i>	<i>Topic</i>
1	1A	<i>Course Introduction; Describing Labor Market Dynamics</i>
2	1B	<i>Unemployed Search Theory</i>
3	1C	<i>Econometrics of Unemployed Search</i>
4	2A,2B	<i>Equilibrium Search: Theory and Estimation</i>
5	3A	<i>Models of Turnover</i>
6	3B	<i>Econometric Models of Turnover</i>
7		<b>Midterm Exam (March 8)</b>
8	4	<i>Comparative Advantage</i>
9	5	<i>Minimum Wages</i>
10	6	<i>Signalling Models</i>
11	7A	<i>Principal-Agent Problems in the Labor Market</i>
12	7B	<i>Econometric Models of Moral Hazard</i>
13	8	<i>Human Capital Investment and Cohort Size</i>

## Reading List

Note: Selections in *italic* are required

### 1A. Describing Labor Market Dynamics

1. Flinn, C. and J. Heckman (1982a). "Models for the Analysis of Labor Force Dynamics" in *Advances in Econometrics*, vol. 1 (Basmann and Rhodes, eds.). JAI Press.
2. Flinn, C. (1986a) "Econometric Analysis of CPS-Type Unemployment Data." **J. of Human Resources** 21: 456-484.
3. Nickell, S (1979) "Estimating the Probability of Leaving Unemployment." *Econometrica* 47: 1249-1266.
4. Lancaster, T (1979) "Econometric Methods for the Duration of Unemployment." **Econometrica** 47: 939-956.
5. Toikka, R. (1976) "A Markovian Model of Labor Market Decisions by Workers." **A.E.R.** 66: 821-834.

### 1B. Search Theories of Labor Market Behavior [Unemployment]

1. Mortensen, D. (1986) "Job Search and Labor Market Analysis." Chapter 15 in *Handbook of Labor Economics, Volume 2* (Ashenfelter and Layard, eds), North-Holland.
2. Lippman, S. and J. McCall (1976a) "The Economics of Job Search, a Survey." **Economic Inquiry** 14: 155-189.
3. Lippman, S. and J. McCall (1976b) "Job Search in a Dynamic Economy." **J. Econ. Theory** 12: 365-390.
4. Benhabib, J. and C. Bull (1983) "Job Search: The Choice of Intensity." **J. Pol. Econ.** 91: 747-764.
5. Danforth, J. (1979) "On the Role of Consumption and Decreasing Absolute Risk Aversion in the Theory of Job Search." In **Studies in the Economics of Search** (Lippman and McCall, eds), North-Holland.

6. Hall, J., S. Lippman and J. McCall (1979) "Expected Utility Maximizing Job Search." In **Studies in the Economics of Search** (Lippman and McCall, eds.), North-Holland.
7. Rothschild, M. (1974) "Searching for the Lowest Price when the Distribution of Prices is Unknown." **J. Pol. Econ.** 82: 689-711.
8. Salop, S. (1973) "Systematic Job Search and Unemployment." *Rev. Econ. Studies* 40: 191-201.
9. Burdett, K. and T. Vishwanath (1988) "Declining Reservation Wages and Learning." **Rev. Econ. Studies** 55: 655-665.

### 1C. Econometric Models of the Search for Employment

1. Flinn, C. and J. Heckman (1982b) "New Methods for Analyzing Structural Models of Labor Force Dynamics." **J. Econometrics** 18: 115-168.
2. Wolpin, K. (1987) "Estimating a Structural Search Model: The Transition from School to Work." **Econometrica** 55: 801-818
3. Van den Berg, G. (1990) "Nonstationarity in Job Search Theory." **Rev. Econ. Studies**
4. Stern, S. (1989) "Estimating a Simultaneous Search Model." **J. Lab. Econ.** 7: 348-269.
5. Lancaster, T. and A. Chesher (1983) "An Econometric Analysis of Reservation Wages." **Econometrica**

### 2A. Equilibrium Models of Employment Search

1. Mortensen, D. (1990) "Equilibrium Wage Distributions: A Synthesis." In **Panel Data and Labor Market Studies** (Hartog, et al, eds).
2. Burdett and Mortensen (1990) "Equilibrium Wage Distributions." mimeo, Cornell University.
3. Lucas, R. and E. Prescott (1974) "Equilibrium Search and Unemployment." **J. Econ. Theory** 7: 188-209.

4. Albrecht, J. and B. Axell (1984) "An Equilibrium Model of Search Unemployment." **J. Pol. Econ.** 92: 824-840.
5. Stiglitz, J. (1985) "Equilibrium Wage Distributions." **Economic J.** 95: 595-618.
6. Burdett, K. and K. Judd (1983) "Equilibrium Price Dispersion." **Econometrica** 51: 955-970.

## **2B. Econometric Models of Equilibrium Employment Search**

1. Eckstein, Z. and K. Wolpin (1990) "Estimating a Market Equilibrium Search Model from Panel Data on Individuals." **Econometrica**
2. van den Berg, G. and G. Ridder (1992) "An Empirical Equilibrium Search Model of the Labor Market." Working paper, Free University of Amsterdam.
3. Bontemps, C., J-M. Robin, and G. van den Berg (1996) "Equilibrium Search with a Continuous Distribution of Productivities: Theory and Estimation." *Mimeo, CREST.*

## **3A. Informational Stories of Turnover**

1. Jovanovic, B. (1979) "Job Matching and the Theory of Turnover." **J. Pol. Econ.** 87: 972-990.
2. Jovanovic, B. (1984) "Matching, Turnover, and Unemployment." **J. Pol. Econ.** 92: 108-122.
3. Burdett, K. (1978) "A Theory of Employee Job Search and Quit Rates." **Amer. Econ. Rev.** 68: 212-220.
4. Burdett, K. and T. Vishwanath (1988) "Balanced Matching and Labor Market Equilibrium." **J. Pol. Econ.** 96: 1048-1065.
5. Crawford, V. and E. Knoer (1981) "Job Matching with Heterogeneous Firms and Workers." **Econometrica** 49: 437-450.
6. Lippman, S. and J. McCall (1981) "The Economics of Belated Information." **Int. Econ. Rev.** 22: 135-146.
7. McDonald, G. (1988) "Job Mobility in Market Equilibrium." **Rev. Econ. Studies** 55: 153-168.

8. Mortensen, D. (1978) "Specific Capital and Labor Turnover." **Bell J. Econ.** 9: 572-586.
9. Mortensen, D. (1988) "Wages, Separations, and Job Tenure: On-the-Job Specific Training or Matching?" **J. Lab. Econ.** 6: 445-471.
10. Salop, S. (1973) "Wage Differentials in a Dynamic Theory of the Firm." **J. Econ. Theory** 6: 321-344.
11. Hashimoto, M. (1981) "Firm-Specific Human Capital as a Shared Investment." **Amer. Econ. Rev.** 71: 475-482.

### 3B. Econometric Models of Turnover

1. Flinn, C. (1986b) "Wage and Job Mobility of Young Workers." **J. Pol. Econ.** 94: S88-S110.
2. Miller, R. (1984) "Job Matching and Occupational Choice." **J. Pol. Econ.** 92: 1086-1120.
3. McCall, B. (1994) "A Dynamic Model of Occupational Choice." **Journal of Econ. Dyn. and Control** 15: 387-408.
4. Flinn, C. (1996a) "Labor Market Structure and Welfare: A Comparative Analysis of Italy and the U.S." mimeo, NYU.
5. Flinn, C. (1996b) "Equilibrium Search under Nash Bargaining." mimeo, NYU.

### 4. Theory and Estimation of Modelsof Compensating Differentials and Comparative Advantage

1. Roy, A. (1951) "Some Thoughts on the Distribution of Earnings." **Oxford Economic Papers** 3: 135-146.
2. Gorman, W. (1980) "A Possible Procedure for Analysing Quality Differentials in the Egg Market." **Rev. Econ. Studies** 47: 843-856.
3. Tinbergen, J. (1951) "Some Remarks on the Distribution of Labor Incomes." **International Econ. Papers** 1: 195-207.
4. Sattinger, M. **J. Econ. Theory**

5. Rosen, S. (1978) "Substitution and the Division of Labor." **Economica** 45: 235-250.
6. Heckman, J. and G. Sedlacek (1985) "Heterogeneity, Aggregation, and Market Wage Fluctuations: An Empirical Model of Self-Selection in the Labor Market." **Jour. of Pol. Econ.** 93: 1077-1125.
7. Willis, R. and S. Rosen (1979) "Education and Self-Selection." *Jour. Pol. Econ.* 87: S7-S36.
8. Keane, M. and K. Wolpin (1996) "Eliminating Race Differences in School Attainment and Labor Market Success." Mimeo, Univ. of Penn.

### 5. Minimum Wages: Theory and Measurement

1. Card, D. and A. Krueger. ***Myth and Measurement: The New Economics of the Minimum Wage.*** Princeton U.P. (1995). Chapters 1,2, and 5.
2. Brown, C. C. Gilroy, and A. Kohen. "The Effect of the Minimum Wage on Employment and Unemployment." **Jour. of Econ. Lit.** (1982): 487-528.
3. Flinn, "Minimum Wage Effects on Labor Market Outcomes under Matching and Bargaining." Mimeo, NYU 1997.
4. Swinnerton, K. "Minimum Wages in an Equilibrium Search Model with Diminishing Returns to Labor in Production." *Journal of Labor Economics* 14 (1996): 340-355.

### 6. Job-Market Signalling

1. Spence, M. (1973) "Job Market Signalling." **Q.J.E.** 87: 355-374.
2. Kreps, D. (1990) ***A Course in Microeconomic Theory***, Ch. 17.
3. Riley, J. (1975) "Competitive Signalling." **J. Econ. Theory** 10: 175-186.
4. Stiglitz, J. (1975) "The Theory of Screening, Education, and the Distribution of Income." **A.E.R.** 65: 283-300.

5. Greenwald, B. (1986) "Adverse Selection in the Labor Market." **Rev. Econ. Studies** 53: 325-347.
6. Berkovitch, E. (1990) "A Stigma Theory of Unemployment Duration." In *Advances in the Theory and Measurement of Unemployment* (Y. Weiss and G. Fishelson, eds.), MacMillan.
7. Waldman, M. (1984) "Job Assignments, Signalling, and Efficiency." **Rand J. Econ.** 15: 255-270.

#### 7A. Moral Hazard and Incentive Problems in the Labor Market

1. Grossman, S. and O. Hart (1983) "An Analysis of the Principal-Agent Problem." **Econometrica** 51: 7-45.
2. Kreps, D. (1990) *A Course in Microeconomic Theory*, Ch. 16.
3. Shapiro, C. and J. Stiglitz (1984) "Equilibrium Unemployment as a Worker Discipline Device." **A.E.R.** 74: 433-444.
4. Foster, J. and H. Wan (1984) "Involuntary Underemployment as a Principal-Agent Equilibrium." **A.E.R.** 74: 476-484.
5. Albrecht, J. and S. Vroman (1990) "Dual Labor Markets, Monitoring, and Search." mimeo, Georgetown University.
6. Malcomson, J. (1984) "Work Incentives, Hierarchy, and Internal Labor Markets." **J.P.E.** 92: 486-507.
7. MacLeod, B. and J. Malcomson (1988) "Implicit Contracts, Incentive Compatibility, and Involuntary Unemployment." **Econometrica**
8. Albrecht, J. and S. Vroman (1996) "Nash Equilibrium Efficiency Wage Distributions." Mimeo, Georgetown University.

#### 7B. Estimation of Models with Moral Hazard

1. Flinn, C. (1993a) "Equilibrium Dismissal without Stigma." In *Labor Demand and Equilibrium Wage Formation* (van Ours, Pfaan, and Ridder, eds.). Amsterdam: North-Holland.
2. Flinn, C. "Equilibrium Wage and Dismissal Processes." **Journal of Business and Economic Statistics** 15 (1997a): 221-236.

## 8. Human Capital Investment and Cohort Size

1. Flinn, C. (1993b) "Cohort Size and Schooling Choice." *J. of Population Economics* 6: 31-55.
2. Welch, F (1979) "Effects of Cohort Size on Earnings: The Baby Boom Babies Financial Bust." *J.P.E* 87: S65-S97.
3. Stapleton, D. and D. Young (1988) "Educational Attainment and Cohort Size." *J. of Labor Economics* 6: 330-361.
4. Siow, A (1984) "Occupational Choice under Uncertainty." *Econometrica* 52: 631-645.